Cochrane Oil & Gas Ltd.

1984 Annual Report

CORPORATE PROFILE

Cochrane Oil & Gas Ltd. is a Canadian independent natural resource company with headquarters in Calgary, Alberta. The Company is involved in the exploration for, and production of oil and gas in Western Canada, Texas, Nebraska and Montana, and is exploring for gold in northwestern Ontario and base metals and silver in British Columbia. Cochrane's common shares are traded on the Alberta Stock Exchange under the symbol COG.

HIGHLIGHTS

Revenue — Increased from $876,000 in 1983 to $2,450,000 in 1984 — increase of 280%.

Net Income — (Before non-cash items) increased from loss of $195,259 in 1983 to net income of $151,362 in 1984 — increase of 177%.

Fixed Assets — Increased from $5,912,094 in 1983 to $16,437,557 in 1984 — increase of 278%.

Gas Production — (Net to Company) increased from 3.0 MMCF/D at end of 1983 to 8.0 MMCF/D at end of 1984.

Wells on Production — (Total Oil & Gas) 25 in 1983; 150 in 1984.

COCHRANE

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ANNUAL MEETING

The Annual Meeting of Cochrane Oil & Gas Ltd. will be held at 2:00 p.m. on June 21, 1985 in the Glengarry Room, Four Seasons Hotel 120 - 9th Avenue S.E., Calgary.

COVER PHOTO

Durango Drilling, Rig #6 drilling a gas well in October, 1984 on Company operated lands at 8-9-19-29 W3M (Burstall, Saskatchewan area). Photo by Doug Wright, Drilling Engineer.







OIL & GAS LTD.







TO THE SHAREHOLDERS

Nineteen eighty-four was a year of consolidation and rapid growth for the Company. Cochrane Resources Ltd., the original wholly owned private subsidiary was amalgamated with Cochrane Oil & Gas Ltd. as of December 31, 1984 to eliminate the duplication of efforts required to run two operating companies. Cochrane Oil & Gas Ltd. also acquired all of the assets of its Limited Partnerships, Cochrane Oil & Gas Program 79 and Cochrane Oil & Gas Exploration Program 82. These acquisitions, along with other additions of producing properties, have helped to build a firm base of good quality reserves that the Company can build on for future growth.

Cochrane, acting as Operator, drilled 50 new wells resulting in 45 gas wells, 2 oil discoveries and 3 dry holes. The Company also purchased an interest in 70 other gas wells and at year end, operated or maintained an interest in some 150 producing gas and oil wells. The Company also operates 3 large gas gathering and compression facilities and installed refrigeration and dehydration equipment to handle 25 MMCF/D at its Armada station.

Current net daily production totals 8.0 Million cubic feet per day gas and 50 barrels per day oil. In addition, the Company custom processes an additional 10 Million cubic feet per day for other producers who have no direct interest in the facilities.

A total revenue of $2.3 million was achieved in 1984 which is an increase of $1.47 million over 1983. It should also be noted that many of the new wells went on stream late in 1984.

Net Reserves presently held by the Company (most of which are on stream) are approximately 100,000 barrels of oil and 20 Billion cubic feet of gas.

The Company continued an exploration program on its gold claims in the Manitou Lakes area of Northwestern Ontario and is currently waiting for the final geological report and interpretation of the geophysical work carried out over the winter. Preliminary results indicate several areas of interest will warrant more detailed work and bulk sampling which will be carried out immediately after spring break-up.

The Company is concerned principally with developing and producing oil and gas, however, other areas such as exploration for minerals and funding research for the extraction of proteins from plant material have been followed up over the last year. These relatively small current investments, although not yielding an immediate cash flow, have the potential to become very significant programs in the future at essentially nominal costs to the Company.

The Company has also built up its exploration and field operations staff to the point where the Company generally operates most of the projects it undertakes.

Cochrane will, therefore, continue to devote virtually all of its efforts towards expanding its holdings and oil and gas production in Western Canada. Although the Company derives a significant income from its U.S. holdings, there are no plans to expend any significant portion of its exploration budget outside of Canada in the immediate future.

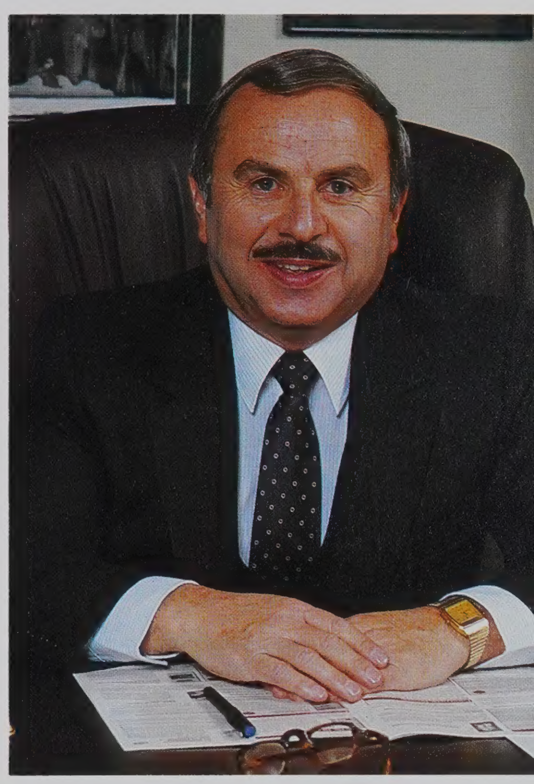
Directors Meeting (*from left to right*) Marina Wenger, *Executive Assistant*, Arthur Hironaka, *Secretary*, Ian MacKay, *Director*, George Isfan, *President*, David Craig, *Vice-President*

For 1985, the Company expects to concentrate its efforts in southern and central Alberta and west central and southeastern Saskatchewan. Two multi-well shallow gas programs, one in the Medicine Hat area of Alberta, and the other in the Burstall area of Saskatchewan will require a large portion of the Company's time and budget for an expected 60 to 80 well commitment. As well, the Company plans to drill several oil prospects in the David area of east central Alberta and is intensively investigating several deeper oil prospects in the Bashaw area of Alberta. A multi-well program is also planned for the Company's land in southeastern Saskatchewan which should overall, with even modest success, tend to balance our oil production with our healthy and ever increasing gas sales.

The Company plans to further expand its compression and processing facilities in the Armada area to handle up to 25 Million cubic feet per day sales gas and extract up to 100 barrels per day natural gas liquids. Several gas prospects and 2 or 3 oil prospects in this area in which the Company retains a large interest are also scheduled to be drilled in 1985.

Cochrane expects to drill and put on production some 75 new wells in 1985 with a gross budget of about $10 million of which the Company's share will be in excess of $3.0 million. This program is a mix of shallow low productivity, but virtually guaranteed production, with a smaller amount of medium depth, but relatively higher risk ventures. Returns from this new drilling and expanded processing facilities should serve to double our gross monthly income by year end and propel us into a much larger program in 1986.

The change in government attitudes and policies mark the start of a new era for junior oil and gas companies operating in Canada. With continued great efforts from all of our employees and considered help from the Board of Directors, we have finally grown into a profitable resource Company with a very bright future ahead of us.



George Isfan, M.A., P. Geol.
President

SUBMITTED ON BEHALF OF THE BOARD,

George Isfan

May 1985

GEORGE ISFAN,
President.

DIRECTORS
George Isfan, Cochrane, Alberta
Arthur Hironaka, Calgary, Alberta
David Craig, Calgary, Alberta
Ian H. Mackay, Calgary, Alberta
Edward Bamlett, Calgary, Alberta

OFFICERS
George Isfan, President & Chief Executive Officer
Arthur Hironaka, Vice-President—Secretary/Treasurer
David Craig, Vice-President—Engineering & Production
Patrick D. Marcotte, Exploration Manager
Ronald D. Reddekopp, Drilling & Production Manager
B. John Schmidt, Controller

EXPLORATION & DEVELOPMENT

WESTERN CANADA

Cochrane, acting as the Operator in all but one well, drilled 48 wells in 1984, resulting in 44 gas wells, 1 oil well, two combined oil and gas wells and 4 dry holes. In addition, 7 previously shut-in gas wells were completed and tied-in. A total in excess of $8.5 million was spent on drilling, completions, pipelines, compressor installation and compressor station upgrading in Saskatchewan and Alberta. In addition, the Company acquired varying interests in about 73 more gas wells in southern Alberta at a cost of $2.4 million. Because the Company was able to get a carried interest in the Burstall project, it was only required to spend about $2.5 million of its own out of a total budget of about $10 million spent in 1984.

Cochrane also acquired all of the assets of its two drilling funds during 1984 which further added about 3.5 BCF and 47 thousand barrels of oil to the Company's reserves. The most significant part of these acquisitions was the large gas handling facilities at Armada that are used to gather and process all of Cochrane's gas from this area, plus custom process an additional 10 million cubic feet per day of other producers' gas. After acquiring these facilities and some oil and gas reserves, Cochrane sold a 50% interest in the gas facilities for $3.0 million cash.

In addition to the acquisition of producing properties, the Company has undertaken a detailed study of prospects in the Medicine Hat, Armada-Eyremore, and central Alberta in the Bashaw area as well as southeastern Saskatchewan. Some of these are oil-prone areas which were selected from the point of view that the Company wishes to more evenly balance its production stream which at present is mostly gas.

The Company maintains an interest in both oil and gas production from areas such as Long Coulee, Hayter, West Smoky, in Albera and Gainsborough in southeastern Saskatchewan.

The bulk of the development work coming up in 1985 will be concentrated in southern Alberta in the Rattlesnake area and Armada areas as well as the Burstall Saskatchewan project. A large seismic program is being planned for southeastern Saskatchewan and a number of offsets to existing production in the Gainsborough area are planned for a 1985 program.

CANADIAN ACTIVITY

Legend

- Cochrane Oil and Gas Properties
- Cochrane Mining Properties

MINING

Cochrane carried out a winter program of geophysics, mapping and sampling on its Manitou Lakes gold claims. The results are currently being evaluated and initially appear to warrant a summer program over specific target areas. A drilling program and bulk sampling and trenching over anomalously high gold value areas is scheduled for the early summer of 1985. Sufficient work will have been done to keep most of the claims in good standing for the next year or two.

U.S. OPERATIONS

Most of the Company's production is derived from its wells in Texas which continued to produce both gas and oil. The wells in Nebraska continued to produce with a very slight decline from the previous year's production and with very few maintenance problems.

The Company participated in one oil well and one abandoned well in Mussel Shell Country in Montana. Production has been sporadic and the well was shut-in over the winter due to production problems. There are no plans for any immediate offsets to these wells.

BURSTALL AREA, SASKATCHEWAN

Cochrane, acting as the Operator over a period of about 90 days, successfully drilled and completed 45 wells, installed 23 miles of pipelines and a compressor station, and went on stream in early December at a rate of 6.7 Million cubic feet per day. This field has been producing at this maximum day rate throughout the first quarter of 1985 with no shutdowns, and with better than expected deliverability.

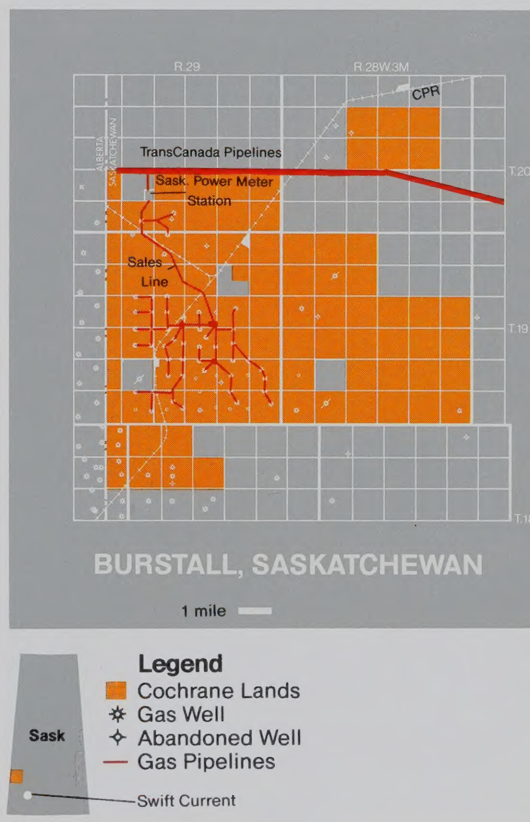
Gas production is obtained from three sands: the shallow blanket type Milk River and Medicine Hat sands and the deeper conventional Viking sands. The Viking pool at the northern edge of the lands was extended to the southeast, and additional drilling will be carried out to the east to further delineate the boundaries of this pool.

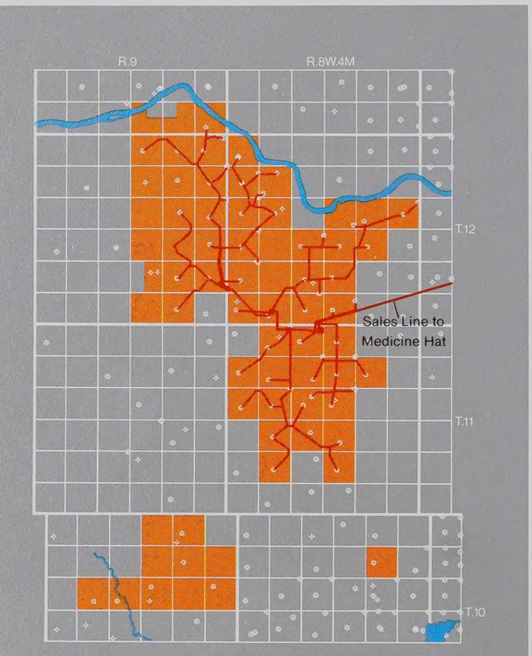
Approximately $5.5 million was spent on this program in 1984 at virtually no cost to Cochrane. The Company farmed out some of its interest in the project and was carried on the drilling, pipelines and compression facilities through 45 wells. The Company receives an operating fee and 6% of the income before payout, and 15% after payout for the entire project.

A very significant oil discovery was made in the southern portion of the lands in sands of Lower Cretaceous or Jurassic age. The oil bearing sand was penetrated in two wells some 3 miles apart, on an east-west line.

The north-south and western extension of the oil pool has not yet been delineated. It would, however, appear that this oil bearing sand should attain an average thickness of ten feet over some 5 to 10 sections of land, and could possibly reach a thickness of 20 to 30 feet over several sections. This excellent quality reservoir with 10 feet of net pay should contain some 10 MILLION BARRELS OF OIL IN PLACE PER SECTION OF LAND. Preliminary production testing produced several hundred barrels of heavy gravity (12° API), viscous oil.

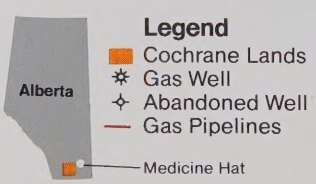
The Company plans to delineate the limits of the oil pool and then commission a feasibility study on the economics of producing this heavy oil. It appears that an enhanced recovery program, in the form of a steam or fire flood, will be necessary to obtain sufficient quantities of oil for the project to be viable.





RATTLESNAKE LAKE, ALBERTA

1 mile



RATTLESNAKE AREA, ALBERTA

The Company, in conjunction with a joint venture partner, purchased a 46% interest in the Rattlesnake lands and wells as of October 1, 1984 for a total price of $1.9 million. The gas is obtained from the Medicine Hat and Second White Specks blanket type sands as well as small Bow Island and Sawtooth Sand pools. The production is sold to the City of Medicine Hat on a long term contract with about 3 Million cubic feet per day of the contract unfilled at year end.

Cochrane is the Operator of the project and plans to carry out an extensive drilling program on this project in 1985. The Company also plans to increase its interest in the area and is investigating prospects in several deeper zones and in large tracts of land in adjoining areas.

With gas contracts and prices firming up and projected excellent long term demands for gas, it is now prudent to acquire as many proven, good quality reserves as possible. Although the average rate of production per shallow gas sand well is only about 100 MCF per day, the producing zones are continuous over large areas and produce for 20 to 30 years.

With good production practices, payout of new shallow gas wells is expected in about 3.0 years.

If any significant deeper reserves, with attendant higher deliverability are discovered, the overall payout time can be reduced by as much as one year for the entire project. The Company is, therefore, carrying out a very intensive study of the general area and expects to drill a large number of wells in this area in 1985.

ARMADA AREA, ALBERTA

The Armada, Eyremore areas of southeastern Alberta, continue to account for a significant amount of the Company's gas sales. Production in the last month of 1984 averaged 6.0 Million cubic feet per day of net gas sales. Gross production through the system, which is owned 50% and operated by Cochrane, averaged about 15 Million cubic feet per day.

Company gas sales from this area are split amongst several discounted industrial sales contracts and TransCanada PipeLines. Two new gas wells, in which the Company retains an 80% interest, were drilled in the latter part of the year and immediately placed on stream. Production from these two wells averages 1.75 Million cubic feet per day.

The Company also purchased a 35.5% interest in a shut-in gas well in the Badger Lake area and placed this well on stream in December at a rate of 1.5 Million cubic feet per day.

The largest increase in net gas production in this area resulted from the purchase of all of the interests held by Cochrane Oil & Gas Exploration Program 82, a Limited Partnership Fund of which the Company was the General Partner. This purchase added 3.5 BCF of gas and 47 thousand barrels of oil to the Company's reserves.

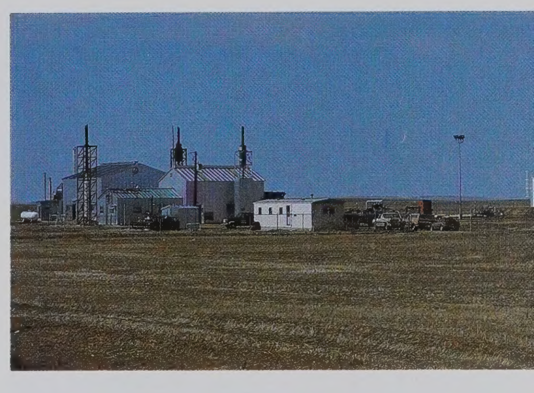
Cochrane also purchased all of the assets of another fund, Cochrane Oil & Gas Program 79, which consisted of the gathering lines, compressor station and sales line, as indicated on the Armada area map. The Company then sold a 50% interest in the project for $3.0 million to a joint venture partner and subsequently proceeded to upgrade the system in 1984 at a total cost of $1.6 million.

This facility is capable of gathering, compressing, dehydrating, removing natural gas liquids by refrigeration, and transporting in excess of 20 Million cubic feet of sales gas per day to a sales point on the Nova system at Scandia, Alberta in Township 16, Range 16, West of the 4th Meridian.

This facility will require the installation of additional pipelines in 1985 to increase its capacity to about 25 million cubic feet per day. This system will ultimately service an area covering in excess of 400 sections of land from Township 16 to Township 20, and from Range 17 to Range 20, all in the Armada, Eyremore and Majorville areas south of the Bow River.

This system is utilized to service Cochrane's lands as well as other producers' gas. An analysis of the potential area to be serviced shows that in excess of 100 BCF of gas is presently discovered, but shut-in. These reserves, plus others that will be discovered, indicate a life span of 15 to 20 years for a facility to move out the gas reserves from this area.

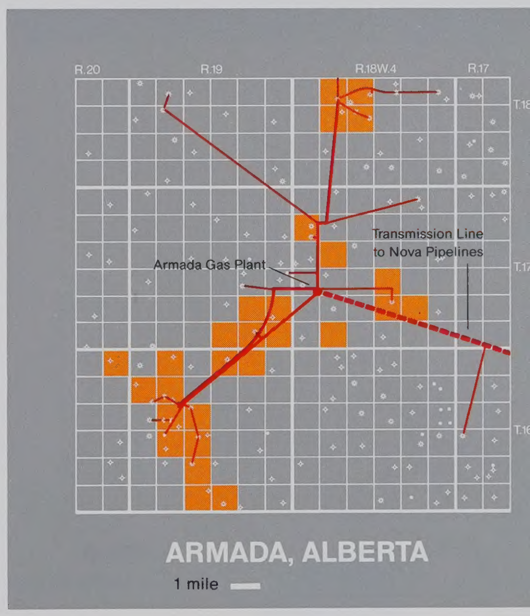
The Company expects to realize a gross income in excess of $1.0 million per year from processing fees and several millions of dollars per year in gas sales from its holdings in the Armada area.

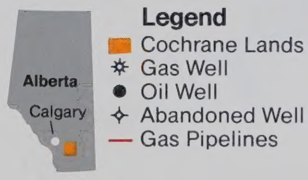


MINERAL EXPLORATION

CRYSTAL CREEK, BRITISH COLUMBIA

Most of the Company's large acreage holdings (about 25,000 acres) are still in good standing and much of it will remain in good standing for several more years. This property surrounds the Ruth Vermont lead, zinc, silver mine which operated intermittently from 1889 to 1980. There are no plans or commitments for further work on this property in 1985.





MANITOU LAKES AREA, ONTARIO

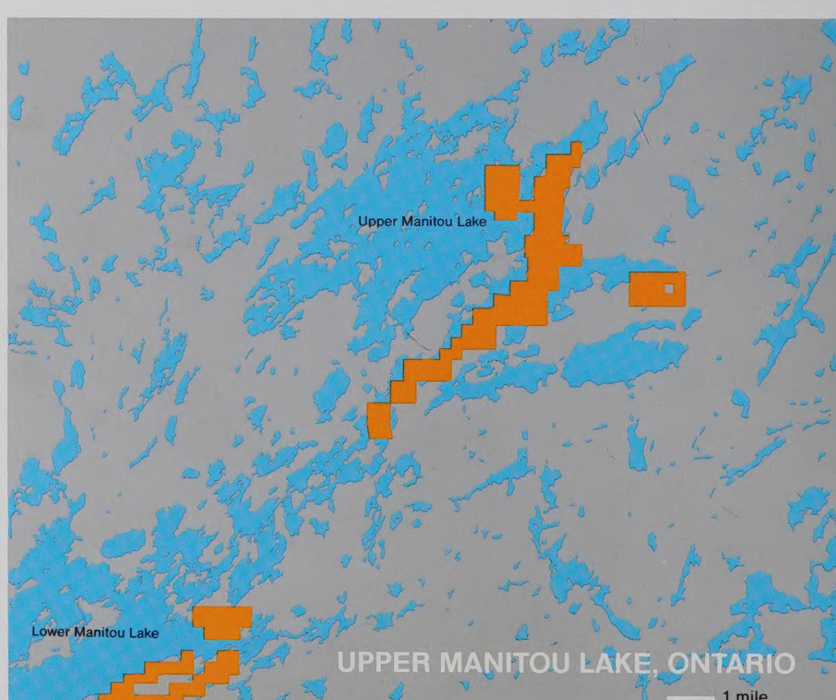
Cochrane retains a 94% working interest in approximately 180 gold claims in the Manitou Lakes area of northwestern Ontario. Some claims held in previous years were dropped after an analysis was carried out on their mineral potential.

A detailed grid pattern of geophysical work was carried out on the presently held claims in the winter of 1984/85, along with sampling and a mapping program. Assays on these samples have pointed out several anomalous areas where gold values are significantly higher than regional values. In most cases, the geophysical work also indicated anomalous readings over these same areas.

Although some of the anomalies have not been drilled, others which are former mine working sites were tested in a limited manner by previous work.

Cochrane is planning to do additional mapping, drilling and bulk sampling at several of these areas of greatest potential and interest in the summer of 1985.

Most of the cost of the work ($85,000.00) carried out in 1984/85 will be defrayed by the OMEP grants receivable from the government of Ontario for previous work carried out in 1983/84. On this basis, the Company decided to further upgrade this property before entertaining proposals for further work on the property by other interested mining companies. The entire mining industry is also, at this time, suffering from the effects of the recession, but should rebound to much greater levels of activity in the next year or two. After having expended a large amount of time, energy and a considerable amount of money, it was felt that it would be best to maintain the property in good standing at very minimal costs until more acceptable proposals concerning the property were received.



CORPORATE SUMMARY

LAND HOLDINGS

The Company held varing interests in a total of 120,160 gross acres (29,122 net acres) in Alberta and Saskatchewan at the end of 1984. These holdings were comprised of 64,610 gross acres (20,682 net acres) in Alberta and 55,550 gross acres (8,440 net acres) in Saskatchewan.

In addition, the Company retains an interest in 10,700 gross acres (1,400 net acres) in the U.S.

PRODUCTION

The Company's average daily gas production increased from 3.0 million cubic feet per day in the first month of 1984 to 8.0 million cubic feet per day in the last month of 1984. This 260% increase can be attributed to acquisitions of producing properties as well as the completion of a large drilling program late in the year.

Oil production remained relatively constant at about 40-50 bbls per day which reflects the concentration of the Company's efforts towards development of gas reserves.

Essentially all of the Company's significant oil and gas reserves are now on stream and will remain on throughout the year. Gas is sold under a variety of contracts, including Saskatchewan Power Corporation in Saskatchewan, TransCanada PipeLines, PanAlberta, City of Medicine Hat and several other discount contracts. New gas reserves discovered in Alberta will only be committed to short-term deliverability type contracts because of the uncertainty of future demand and prices.

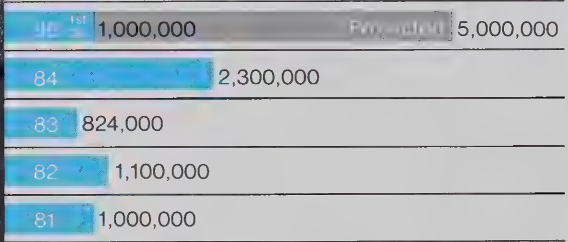
RESERVES

The Company at year end had reserves (net after royalties) of about 20 BCF of gas and 100,000 barrels of oil in its Canadian and U.S. properties. Virtually all of these reserves are producing or proven with only a small amount left in the probable category.

The Company's reserves are reviewed annually by independent engineering firms who provide estimates of the cash flow which can be expected from the marketing of these reserves in future years.

The estimate of the undiscounted value of the Company's future cash flow from its oil and gas reserves and custom processing of gas is $97 million. Applying a 15 % discount factor the present value is estimated to be $30 million.

GROSS REVENUE (in dollars)



FINANCIAL REVIEW

Total revenue increased 280% from $876,097 in 1983 to $2,454,420 in 1984. Most of this can be attributed to the large increase in gas sales which was achieved by drilling and acquisitions.

Net cash flow from operations increased from a loss of $195,259 in 1983 to a net of $151,362 in 1984. Most of this positive cash flow was generated in the last quarter when most of the wells went on stream.

The loss for the year of $365,325 was realized as a result of extraordinary items and items not requiring funds. The extraordinary items resulted in large part from the amalgamation of Cochrane Resources Ltd. (a wholly owned subsidiary) with Cochrane Oil & Gas Ltd. and in part from the acquisition of the two Cochrane operated funds.

The Company also showed an increase in its working capital position of $1,621,575 for the year by restructuring its bank debt which formerly was carried as a current liability instead of a long-term debt.

The sum of $900,000 which is indicated as a note receivable is included in the long-term debt total of $8,176,480 and is serviced by production income from the Rattlesnake properties. All of the new debt incurred in 1984 was used for acquisitions of producing properties. Each property can service its share of debt on a stand-alone basis, while in all cases, each property acquired has room for expansion to enhance its cash flow in the future.

The acquisitions are reflected in the large increase in fixed assets which increased from $5.9 million in 1983 to $16.4 million in 1984.

The amalgamation of the wholly owned subsidiary and acquisition of the Cochrane operated fund will greatly simplify operations particularly in the accounting areas, leaving the parent company with a U.S. subsidiary and an inactive Canadian subsidiary.

Much of the restructuring of the Company occurred late in 1984 which consequently had a small effect on 1984 operations. The large increase in revenue and net income will be evident in 1985 operations beginning with the first quarter of 1985. These much improved results have also not been available to the market place up to this time. Reasonable projections based on current operations only, suggest a positive net cash flow in the range of 20 cents per share should be realized in 1985. This suggests that the market price of the common shares which are currently trading in the 50 cent range are discounted much more severely than they should be, even in a depressed oils market. A concerted effort is being undertaken to improve the trading price to a level which would more accurately reflect the true value of this Company.

Cochrane Oil & Gas Ltd.

CONSOLIDATED BALANCE SHEET

AS AT DECEMBER 31, 1984

	1984	1983
ASSETS		
CURRENT ASSETS		
Cash and term deposits	$ 249,537	$ 22,886
Accounts receivable	3,055,263	731,669
Due from shareholders	8,379	—
Deposits and prepaid expenses	41,103	38,583
	3,354,282	793,138
RECEIVABLE ON SHARE PURCHASE OPTION PLAN (note 5[e])	25,000	105,000
NOTE RECEIVABLE, secured by fixed assets and bearing interest at prime plus 1½%	900,000	—
FIXED ASSETS (note 2)	16,437,557	5,912,094
OTHER ASSETS	10,000	10,000
	$20,726,839	$6,820,232
LIABILITIES		
CURRENT LIABILITIES		
Bank loan	$ —	$2,203,349
Accounts payable and accrued liabilities	3,911,889	761,743
Due to shareholders	—	7,228
	3,911,889	2,972,320
LONG TERM DEBT (note 3)	8,176,480	—
GAS PRODUCTION PREPAYMENTS (note 4)	589,583	384,906
DEFERRED INCOME TAXES	539,906	528,506
SHAREHOLDERS'EQUITY		
CAPITAL STOCK (note 5)		
Preferred shares	3,945,500	—
Common shares	5,043,794	4,049,488
DEFICIT	(1,480,313)	(1,114,988)
	7,508,981	2,934,500
	$20,726,839	$6,820,232

CONTINGENT LIABILITIES AND COMMITMENTS (note 10)

Approved by the Board

George Ifon? Director

A. Hunka? Director

YEAR ENDED DECEMBER 31, 1984	**1984**	1983
REVENUE		
Petroleum and natural gas sales	**$ 1,458,050**	$ 558,615
Processing revenue	**583,791**	—
Interest and other	**412,579**	317,482
	2,454,420	876,097
EXPENSES		
Well operating costs	**414,899**	248,794
Processing costs	**141,533**	—
Interest - long term debt	**591,074**	—
- other	**196,568**	273,942
General and administrative	**336,194**	387,312
Professional and consulting fees	**356,198**	195,892
Project evaluation expenses	**336,592**	208,206
Overhead costs recovered	**(70,000)**	(242,790)
	2,303,058	1,071,356
FUNDS GENERATED FROM (APPLIED TO) OPERATIONS	**151,362**	(195,259)
CHARGES NOT REQUIRING FUNDS		
Depreciation and depletion	**425,287**	112,535
Other expenses	**80,000**	82,853
Deferred income taxes (note 7)	**408,300**	2,600
	913,587	197,988
Loss before extraordinary item	**(762,225)**	(393,247)
Utilization of loss carry forwards on corporate reorganization	**396,900**	—
LOSS FOR THE YEAR	**(365,325)**	(393,247)
DEFICIT AT BEGINNING OF YEAR	**(1,114,988)**	(721,741)
DEFICIT AT END OF YEAR	**$(1,480,313)**	$(1,114,988)
PER COMMON SHARE, based on the weighted average number of shares outstanding		
Funds generated from (applied to) operations	**$ .03**	$(.04)
Loss before extraordinary item	**$(.15)**	$(.09)
Loss for the year	**(.07)**	(.09)

YEAR ENDED DECEMBER 31, 1984	1984	1983
WORKING CAPITAL DERIVED FROM		
Operations	$ 151,362	$ —
Proceeds on sale of fixed assets	3,000,000	—
Long term debt	8,176,480	—
Capital stock	4,939,806	287,050
Gas production prepayments	—	11,028
	16,267,648	298,078
WORKING CAPITAL APPLIED TO		
Operations	—	195,259
Acquisition of Limited Partnerships	9,945,984	—
Note receivable	900,000	—
Fixed assets	3,777,291	966,240
Gas production prepayments	22,798	—
Other assets	—	10,000
	14,646,073	1,171,499
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	1,621,575	(873,421)
WORKING CAPITAL DEFICIENCY AT BEGINNING OF YEAR	2,179,182	1,305,761
WORKING CAPITAL DEFICIENCY AT END OF YEAR	$ 557,607	$2,179,182

To the Shareholders of
Cochrane Oil & Gas Ltd.

We have examined the consolidated balance sheet of Cochrane Oil & Gas Ltd. as at December 31, 1984 and the consolidated statements of earnings and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1984 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Riddell

Chartered Accounts

Calgary, Canada
March 29, 1985

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 1984

1. ACCOUNTING POLICIES

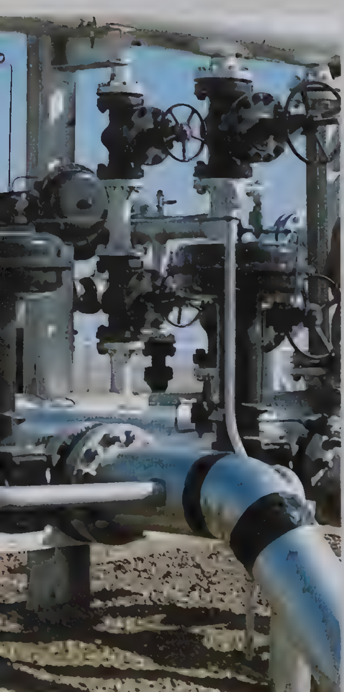
(a) Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, 200316 Holdings Ltd., and Cochrane Oil & Gas Inc.

(b) Petroleum and Natural Gas Operations

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical expense, carrying charges of non-producing property and the costs of drilling both productive and non-productive wells. These costs are depleted on a North American cost centre basis using the unit of production method based on estimated recoverable reserves of petroleum and natural gas as determined by the Company.

The Company's capitalized costs less accumulated depletion and depreciation are limited to an amount equal to the estimated value of future net revenues from estimated proven developed reserves (based on current prices less operating costs).



Substantially all of the Company's exploration and production activities are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

(c) Mining Claims

Mining claims are recorded at the original cost of all claims acquired in each area of interest. Exploration and other expenditures pertaining thereto have been deferred and will be amortized, together with the cost of the related mining claims, against production from future mining operations. If any claims in an area of interest are surrendered, the cost of the claims and the related exploration expenses will be charged to earnings.

All of the mining claims are in the exploratory and development stage and a determination has not yet been made whether these properties contain reserves that are economically recoverable. The recoverability of the amounts shown for mining claims and deferred expenditures are dependent upon the existence of economically recoverable reserves and upon future profitable production.

(d) Depreciation

Depreciation is provided on the diminishing balance basis at rates which will amortize the assets over their estimated useful lives.

(e) Foreign Currency Translation

All monetary assets and liabilities denominated in U.S. currency are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other assets are translated at historical exchange rates. Revenue and expense items (excluding depreciation and depletion which are translated at the same rates as the related assets) are translated at the average rate of exchange for the period. Exchange gains and losses are included in earnings for the year.

(f) Comparative Accounts

Certain of the comparative accounts have been reclassified to conform with the financial statement presentation adopted in 1984.

2. FIXED ASSETS

	1984			1983
	Cost	Accumulated Depreciation and Depletion	Net	Net
Petroleum and natural gas leases and rights including exploration, development and equipment thereon	$12,256,716	$799,792	$11,456,924	$5,544,252
Gas processing plant and facilities	4,113,784	101,717	4,012,067	—
Office equipment	169,444	44,847	124,597	15,351
Leasehold improvements	153,924	23,674	130,250	6,055
	16,693,868	970,030	15,723,838	5,565,658
Mining claims	162,000	—	162,000	22,000
Drilling and camp equipment	18,804	17,421	1,383	6,950
Deferred expenditures	550,336	—	550,336	317,486
	731,140	17,421	713,719	346,436
	$17,425,008	$987,451	$16,437,557	$5,912,094

3. LONG TERM DEBT

	1984	1983
Bank operating loan	$3,828,351	$ —
Bank production loan	2,056,353	—
Bank demand loans	2,291,776	—
	$8,176,480	$ —

The bank loans bear interest from 1¼% to 1½% above the bank's prime lending rate. The loans are evidenced by demand promissory notes and are secured by the Company's petroleum and natural gas properties and fixed and floating charge debentures.

Subsequent to December 31, 1984 the bank demand loans have been replaced by a term lending facility in the amount of $900,000 and a revolving line of credit. The interest rates and securities pledged remain unchanged.

The bank loans are repayable out of future production and accordingly, their repayment is not expected to require the use of existing working capital; therefore, no portion of the loans has been included in current liabilities.

The estimated principal repayments on the bank loans are as follows: 1985 - $789,274; 1986 - $996,358; 1987 - $1,144,690; 1988 - $1,272,037; 1989 - $760,961.

4. GAS PRODUCTION PREPAYMENTS

Amounts received for annual contracted natural gas volumes not taken by pipeline purchasers are deferred and will be recognized as revenue when deliveries are made over a ten year period commencing November 1, 1984.

5. CAPITAL STOCK

(a) During the year, the Company was continued under the Business Corporations Act (Alberta) and increased its authorized share capital to:

50,000,000 Common shares without par value.

50,000,000 Common shares without par value and non-voting.

10,000,000 First Preference Shares with a minimum issue price of $10 per share, to be issued in series at prices and terms to be determined by the Company's directors.

10,000,000 Second Preference Shares with a minimum issue price of $10 per share, to be issued in series at prices and terms to be determined by the Company's directors.

(b) Changes in the Company's outstanding share capital during the year were as follows:

(i) Preferred Shares	Number of Shares	Amount
Issued		
—on acquisition of Cochrane Oil and Gas Program 1979, First Preference, Series A	210,000	$2,100,000
—on acquisition of mining claims First Preference, Series A	14,000	140,000
Issued and to be issued		
—on acquisition of Cochrane Exploration Program 1982, First Preference, Series B	125,280	1,252,800
—for exploration and development expenditures, Second Preference, Series A, less related Petroleum Incentive Program payments of $257,300	75,000	492,700
Converted to Common Shares First Preference, Series A	(4,000)	(40,000)
Balance, December 31, 1984	420,280	$3,945,500

(ii) Common Shares	Number of Shares	Amount
Balance, December 31, 1983	4,949,711	$4,049,488
Issued		
—on exercise of employee share purchase options	88,077	38,600
—on private placement	100,000	68,666
—on conversion of First Preference Shares, Series A	32,000	40,000
—as stock dividend on Convertible First Preference Shares, Series A	162,847	—
—in exchange for consulting services	50,000	50,000
Issued and to be issued		
—on acquisition of Cochrane Exploration Program 1982	1,328,400	797,040
Balance, December 31, 1984	6,711,035	$5,043,794

5. **CAPITAL STOCK (CONTINUED)**

(c) The Company may elect to issue common shares in lieu of cash dividends on the first preferred shares, Series A and B. The common shares issued under this option will be at a price based upon the trading price of such shares on The Alberta Stock Exchange and have been treated for accounting purposes as a stock dividend and, accordingly, no value has been attributed thereto.

The 8% cumulative redeemable convertible first preferred shares, Series A and B are redeemable at $10.20 per share after February 28, 1987 and are convertible, at any time, into common shares at a price of $1.25 per share to March 1, 1989.

The retractable convertible second preferred shares, Series A are retractable at $18.75 per share after March 15, 1990 and are convertible at any time, into common shares at a price of $.80 per share to February 16, 1990.

(d) The Company has issued the following share purchase options:

(i) 133,750 shares under the Company's Employee Share Purchase Plan at prices varying from $.34 and $.59 per share expiring in 1987 and 1989, respectively.

(ii) 351,923 shares to a consultant of the Company at a price of $.52 per share expiring in 1988.

(e) The receivable on the share purchase option plan relates to the issuance to employees, under the terms of a share purchase option plan, of 50,000 common shares of the Company. The shares are held by The Canada Trust Company to be released upon payment for the shares up to May 22, 1985.

6. **SEGMENTED INFORMATION**

The Company is engaged in only one business segment, the exploration for and development and production of petroleum and natural gas. Information representing the Company's operations by geographic segment is as follows:

1984	Canada	United States	Total
Gross revenues	$ 1,795,685	$ 246,156	$ 2,041,841
Operating profit	$ 904,295	$ 155,827	$ 1,060,122
Interest and other income			412,579
Interest expense			(787,642)
General corporate expenses			(1,038,984)
Loss before income taxes and extraordinary item			$ (353,925)
Identifiable assets	$19,435,970	$1,290,869	$20,726,839

1983	Canada	United States	Total
Gross revenues	$ 287,805	$ 270,810	$ 558,615
Operating profit	$ 11,108	$ 186,178	$ 197,286
Interest and other income			317,482
Interest expense			(273,942)
General corporate expenses			(548,620)
Abandonment of mineral claims			(82,853)
Loss before income taxes			$ (390,647)
Identifiable assets	$ 5,590,729	$1,229,503	$ 6,820,232

7. **INCOME TAXES**

(a) As at December 31, 1984, the Company had the following deductions available to reduce future years' earnings for income tax purposes, the effect of which has not been recorded in the accounts (all subject to final determination by taxation authorities):

(i) Canada	
Loss carry-forwards (expiring in varying amounts beginning in 1985)	$475,000
(ii) United States	
Loss carry-forwards (expiring in varying amounts beginning in 1995)	$531,000
Excess of net book values over tax values	(460,000)
	$ 71,000

7. **INCOME TAXES (CONTINUED)**

(b) Fixed assets include unamortized costs of approximately $4,617,000 which are not deductible for income tax purposes by the Company.

(c) Deferred income tax expense differs from the amounts which would be obtained by applying the Canadian and U.S. basic federal tax rates to the respective years' earnings before income. These differences result from the following items:

	1984	1983
Computed "expected" tax recovery	$(162,800)	$(179,700)
Non-deductible Crown charges net of provincial credits	74,900	9,500
Non-allowable depletion of costs of acquired assets with no tax basis	467,800	—
Depletion allowances on Canadian oil and gas production income	—	(7,000)
Federal resource allowance	(41,700)	(30,800)
Provincial and state income taxes less federal abatements and surtaxes	700	1,600
Other non-deductible expenses	36,800	—
Operating losses on which the benefit has not been recorded	32,600	209,000
	$ 408,300	$ 2,600

8. **BUSINESS COMBINATIONS**

(a) Effective January 1, 1984 the Company acquired the limited partners' interests in the Cochrane Oil and Gas Program 1979 ("Program 79") for an aggregate consideration of 210,000 First Preference, Series A shares at an ascribed value of $2,100,000 together with $1,238,901 cash (including outlays and expenses). This business combination has been accounted for as a purchase and the results of Program 79 have been included in these consolidated financial statements from the effective date of acquisition.

The acquisition is summarized as follows:

Current assets		$ 155,556
Current liabilities		(3,403,852)
		(3,248,296)
Fixed assets		
Gas processing plant and facilities	$2,218,522	
Petroleum and natural gas properties	725,665	2,944,187
Gas production prepayments		(227,475)
Excess purchase consideration assigned to fixed assets		3,870,485
Purchase consideration		$3,338,901

(b) Effective December 31, 1984 the Company acquired the limited partners' interests in the Cochrane Exploration Program 1982 ("Program 82") for an aggregate consideration of 125,280 First Preference, Series B shares at an ascribed value of $1,252,800 together with 1,328,400 common shares at an ascribed value of $797,040 and $1,477,540 cash (including outlays and expenses). This business combination has been accounted for as a purchase.

The acquisition is summarized as follows:

Current assets	$640,762
Current liabilities	(582,169)
	58,593
Petroleum and natural gas properties	1,267,975
Excess purchase consideration assigned to petroleum and natural gas properties	2,090,812
Purchase consideration	$3,417,380

(c) Effective December 31, 1984 the Company amalgamated with its subsidiary, Cochrane Resources Ltd. and will continue under the name of Cochrane Oil & Gas Ltd.

9. **OTHER INFORMATION**

The total remuneration paid to directors and senior officers of the Company which by statute includes the five highest paid employees amounted to $295,860.

Certain officers and directors participate in certain joint ventures with the Company on the same or similar terms as other participants.

10. **CONTINGENT LIABILITIES AND COMMITMENTS**

(a) The Company has guaranteed the obligations of an unrelated company to a maximum of $100,000 as part of the terms of their 20% investment in that company. The shares representing their 20% investment have been pledged as additional security on that company's loans.

(b) The Company has lease agreements in respect of office premises for which future minimum payments for the next five years are approximately as follows:

1985	$138,900
1986	87,955
1987	87,955
1988	118,111
1989	49,213
	$482,134

CORPORATE INFORMATION

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Calgary, Alberta T2P 3N9
Telephone: (403) 233-7100

BANKERS

The Bank of Montreal, Calgary, Alberta
Canadian Commercial Bank, Calgary, Alberta

SOLICITORS

Burnet Duckworth & Palmer, Calgary, Alberta
Macleod Dixon, Calgary, Alberta

AUDITORS

Thorne Riddell, Calgary, Alberta

TRANSFER AGENT AND REGISTRAR

The Canada Trust Company, Calgary, Vancouver, Regina, Winnipeg

STOCK EXCHANGE

Alberta Stock Exchange
Stock Symbol — COG

PHOTOGRAPHY
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Cochrane Oil & Gas Ltd.

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